RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Nov. 1, 1989 **LETTER 1029**

Oct. 20 DJIA 2689.14; PTI 3275; A-D Ratio -6.74
Oct. 27 DJIA 2596.72; PTI 3257; A-D Ratio -8.14
Dow Yield: 3.97%; Dow P/E: 11.2; DowPow: 560
Dow Book Value: 1075; Dow 200-day MA: 2481
Percentage of Undervalued Blue-chips: 15%

THE PICTURE: Friday, 6:30 a.m. -- I flipped on the TV and turned to channel 26 which is Financial News Network (FNN) here in San Diego. The Dow opened down 7, and I growled to my wife, Faye, "These opening and intra-day prices don't mean a damn thing any more. The Dow could be down 30 points in the next hour and be up 50 points by the close." "Then what are you watching it for?" questioned Faye. "Habit," I replied, "just dumb habit."

The Oct. 27 *New York Times* (front-page piece) states that Japan is in the midst of a tremendous business boom with expansion of capital goods, research, and development far outpacing the US. In the first eight months of 1989, for instance, Japanese corporations raised $110 billion for expansion and development, compared with $20 billion raised by American corporations. This is the widest disparity ever between the two nations. An expert is quoted as follows: "The really awesome thing is what this will mean in three or four years, when the Japanese begin to realize the benefits of their investments and their productivity shoots up." In an equally ominous front-page piece (Oct. 26), the *WSJ* notes that the Japanese are not obsessed with profits -- what they are obsessed with is holding or increasing market share.

In the meantime the US continues to live over its head, running up the federal debt at the rate of around $250 billion a year or roughly $680 million per day. While the debt machine runs, foreigners buy up US assets, and, of course, the profits from these assets are shipped overseas. Asset shuffling continues to be the major preoccupation of US businessmen, a process that loads corporations with debt while doing nothing for their competitiveness.

Under these circumstances, I don't see how the dollar can hold up over the long run. Ultimately, there must be a run on the dollar. When the dollar finally goes, the bond market will go with it. Some of this may be what the stock market is discounting now.

The reaction to the October 13 crash was most interesting. What struck me about the comments was they all seem to deal with the crash as if it were a single, isolated incident. "What caused the crash?" the analysts ponder. "It was program trading, no it was the unraveling of the UAL deal, no it was the Fed's tight money, well, no it was simply the market's way of cleansing away some of the overspeculation."

I think the really significant part of the post-crash picture is that nobody's been talking about the crash in terms of it being the signal for a major reversal in the market's trend. When the Dow (the Dow, not the general market) bounced back 88 points on Monday, October 16, and then another 39 points on October 19, the reaction was, "See, all is well, the market's recouped half its crash losses, and it only took a few days."

As a longtime student of market psychology, I've noticed that the public tends to be guided by the experience of the most recent past. Thus, when the market crashed two years ago in 1987, the only comparable disaster was the crash of 1929. Therefore, the general reaction was, "This is another '29 crash. After the '29 crash we saw a big upward correction, then business turned bad, and within a year we were in the Great Depression. It's 1987, and we've had another historic crash. So it's all over -- let's get out of the market and let's prepare for the second great depression."

But it didn't happen that way. The Averages headed up, and before 1989 was over the Dow and the Transports were at new record highs.

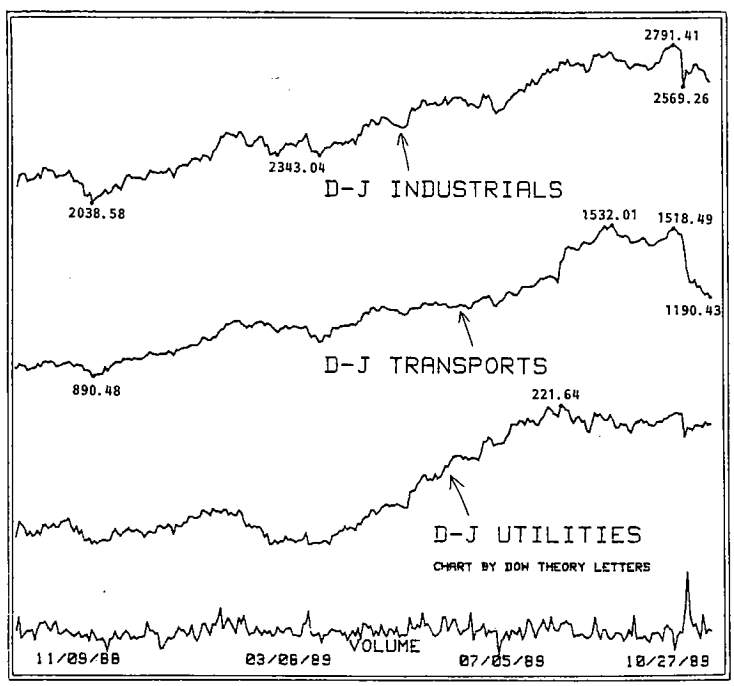
"Ah," reasoned the public, "the crash of '87 was a fake-out. The sellers, the 'chicken littles,' they were all suckered out of the market. And now, here in October 1989 we've suffered another crash. But whereas 1987 saw 508 points ripped off the Dow on crash day, this time the Dow only lost 190 points. Hey, that's not so bad. The Dow will be at new highs before 1989 is out."

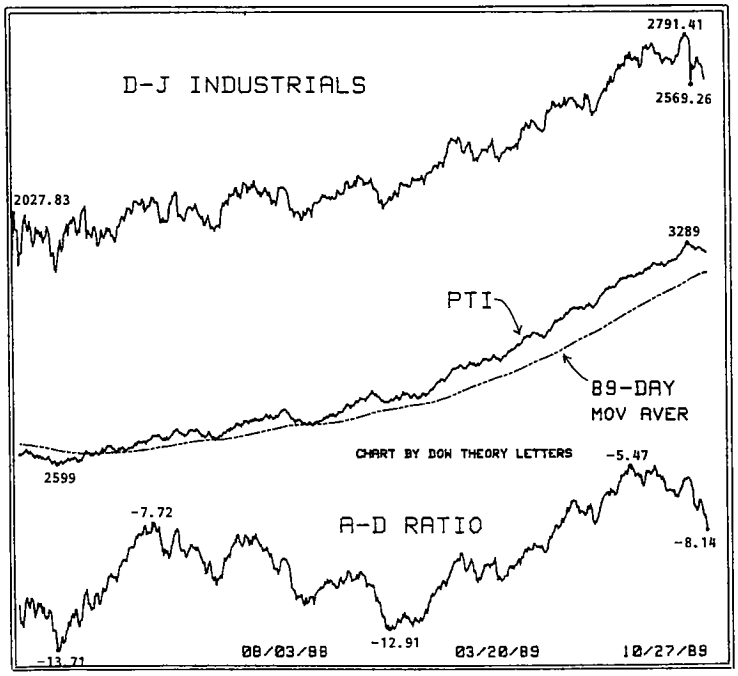
Of course, that's possible, and the psychology and the optimism of the day may prove to be correct. But I have my doubts. The stock market seldom does the same thing twice in a row. Consistency would make the market game too easy. What the stock market does try to do is take our money. That's why there are so few longtime winners on Wall Street.

After studying the market action of the past few weeks I've come up with a few observations and conclusions. Here they are: (1) I believe the D-J Transportation has topped out for the duration. And when I say "the duration," I mean the Transports have topped out for this bull market, and perhaps for years to come.

(2) The advance-decline ratio appears to have topped out too. Well let me put it this way, I'd say the odds are three-to-one that the A-D has topped out.

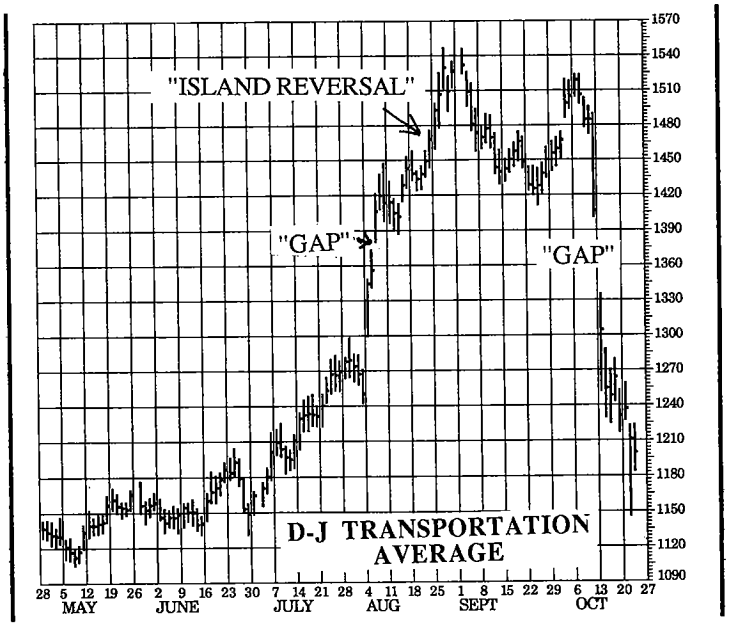
(3) The five-day average of daily new lows on the NYSE has moved above the five-day average of new highs. This is a very negative indication.





(4) My Primary Trend Index (PTI) is looking ragged. On October 23 the PTI broke below a seven-month rising trendline, a trendline that started at the March low (see page 2 chart). True, the PTI has not yet fallen below its 89-day moving average, but it has traced out a downward zigzag. The next step will be to see whether the PTI establishes a definitive downward trend and whether it breaks below its moving average.

(5) IF the D-J Transportation Average has, indeed, topped out, then the bull market (by Dow Theory definition) is over. Even if the Industrial Average rallies to a new high, such a move would almost surely be unconfirmed by the Transports. For reference purposes, it is well to remember that the D-J Transportation Average recorded its high on **September 5** at **1532.01.**



More on the Transports: I include a daily arithmetic chart of the Transportation Average (courtesy of the *WSJ*), and here's a fascinating point. We have a double top in the 1510-1540 area. We also have twin gaps, one on the (left) upside of the top formation, and one on the (right) downside, the downside gap being a product of the crash. A gap in any stock average is quite rare. A gap is formed when the extreme of one day fails to overlap the extreme of the preceding day.

When a top-formation is separated by two gaps (one on the upside and one on the downside) it leaves the price movement suspended in mid-air. Such a formation is termed an "island reversal." An island-reversal often marks the end of a move.

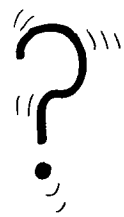
One of the most fantastic island reversals I've ever seen in an average now shows in the chart of the D-J Transportation Average. I have labeled the gaps in the average, and you can see the huge island reversal pattern clearly. My feeling is that this formation will offer massive resistance to any attempt by the Transports to rally to new highs again.

Conclusion: Every bull market in history has ultimately come to an end. What are the odds that this bull market has ended, and that the current action is simply a further extension of what appears to be a huge top? In a word, I'd say the odds are "good, very good that the tide has turned."

FULLER: I just received a special interim report from *Fuller Money*. This is a very good international advisory, one that I've been following for a few years (7 Swallow St., London WIR 7 HD, UK). David Fuller has been outstanding on international markets, and here's what he says now: "BEAR MARKETS CONFIRMED. The DJIA's 190 point plunge provides dramatic confirmation of the new bear trend for global stock markets. . . . All previous stock market bull trends are now over. In other words, we have seen the final peaks for all industrial/financial indices for this cycle. . . . The initial stages for the bear market will unfold rapidly. Steep declines will be the norm. . . . Continental Europe's high-flying bourses will be among the hardest hit. . . . Japan should experience the smaller overall bear market. . . . The dollar will fall below DM1.80 and ¥135. . . . Cash is king." Russell comment: As I said, Fuller has been very, very good.

Russell conclusion: I'm going to be guided very strongly by what my PTI does. So far, the PTI looks toppy, but it has not yet broken below its important 89-day moving average.

INVESTMENT POSITION: I like these markets less and less. The stock market is acting poorly with the Transports almost out-of-sight on the downside and the A-D ratio now badly damaged. The chorus of predictions for lower interest rates and higher bond prices is almost deafening. Frankly, I find myself skeptical about the coming "boom for bonds," particularly since the public is loaded with bond funds of every type and variety.

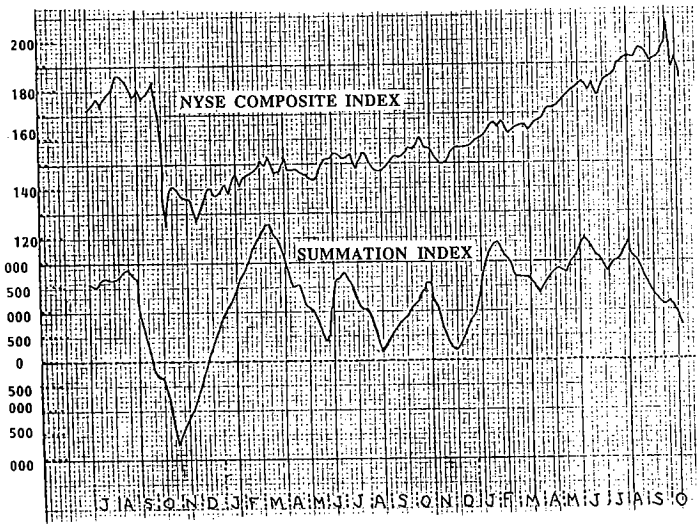


Personally I feel comfortable being almost entirely in money-market funds. If the PTI breaks down below its 89-day moving average and establishes a decisively bearish trend, I may even switch from money-market funds to 91-day Treasury bills.

A question mark is in the box, but even the question mark is a bit shaky. If the PTI goes, the bear will take over the box.

SUMMATION INDEX: Everything I wrote about the Summation Index (SI) in the last Letter was correct. But thanks to a few letters from subscribers I found that my hand-held computer had a glitch in it. The glitch shows that the direction of the SI was correct, but the LEVEL of the SI on the chart was wrong. The computer I had been using produced a downward bias in the SI. The corrected SI chart is shown here (page 3). From this chart you can see that the SI is still far from a extreme oversold condition, but the direction of the SI is still down.

After much pondering, I have decided not to include a chart and discussion of the SI in each Letter. I feel the SI is too slanted



toward shorter-term market action. However, I will talk about the SI when I feel it is portraying something very important (such as a major overbought or oversold situation). By the way, those who would like a more detailed running discussion of the SI should write to my good friend, Ken Gammage of *The Richland Report,* Box 222, La Jolla, CA 92038.

CHARTS: Pardon me for including so many of Ed Hyman's charts (from *C.J. Lawrence*), but Ed's charts, in my opinion, tell the most incisive story about the economy that is obtainable anywhere.

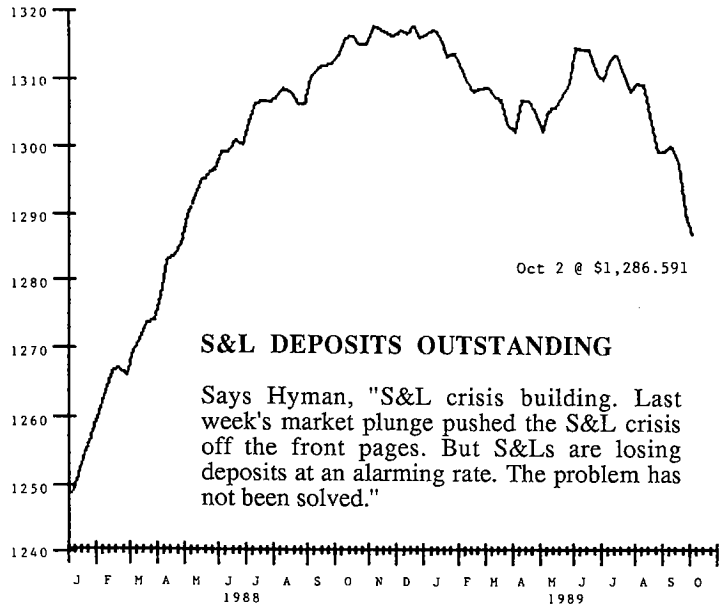
Does money matter? The first chart shows the year-to-year percentage change in the broad M-3 money supply. It dropped to a record year-to-year low a few weeks ago.

The second chart points to an area where no one seems to be looking any longer (but Ed is). That's the deposit flow in or out of the S&Ls. Money is still exiting the S&Ls, and it's exiting fast. If this keeps up, there's going to be trouble. Or should I say renewed trouble?!

The next chart shows corporate debt as a percentage of corporate assets. The debt/asset ratio is exploding, and is now at a record high. Rising debt ratios "need" inflation. That's what keeps everything floating along today -- inflation. Take away the inflation and corporations will be facing a mighty squeeze. Will Greenspan, who professes to want "zero inflation," take a chance on the "mighty squeeze"? Stay tuned.

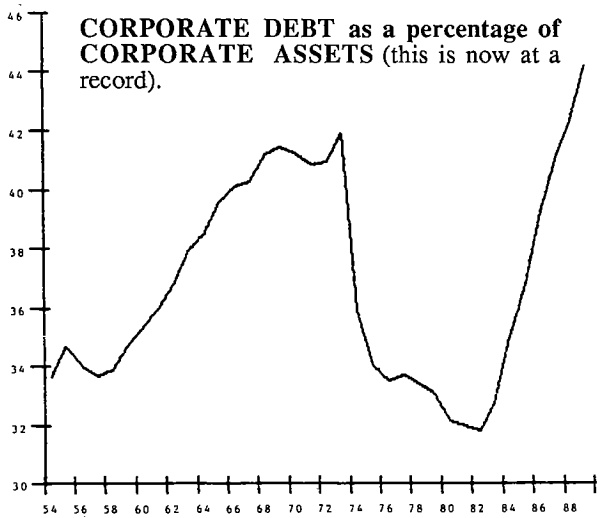
M3 (Year to Year percentage)

Hyman says, "M3 has shown no growth for almost 3 months and hit a record low year-on-year gain last week."

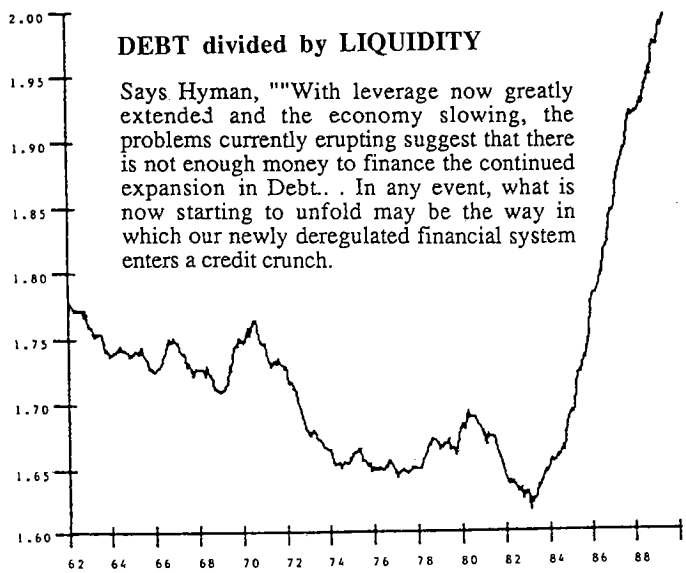


S&L DEPOSITS OUTSTANDING

Says Hyman, "S&L crisis building. Last week's market plunge pushed the S&L crisis off the front pages. But S&Ls are losing deposits at an alarming rate. The problem has not been solved."



CORPORATE DEBT as a percentage of CORPORATE ASSETS (this is now at a record).



DEBT divided by LIQUIDITY

Says Hyman, ""With leverage now greatly extended and the economy slowing, the problems currently erupting suggest that there is not enough money to finance the continued expansion in Debt.. . In any event, what is now starting to unfold may be the way in which our newly deregulated financial system enters a credit crunch.

The last chart shows US debt divided by Liquidity. Writes Ed Hyman, "With leverage now greatly extended and the economy slowing, the problems that are currently erupting suggest that there is not enough money to finance the continued expansion in Debt. Although Debt growth has slowed, it is still growing significantly faster than money. In any event, what is now starting to unfold r

be the way in which our newly deregulated financial system enters a credit crunch." In other words, Hyman thinks the credit crunch may now be starting.

THE GREAT DISGRACE: I doubt if anyone in my industry has written more (over more years) about the US budget deficits than I have. I can't be sure, but I suspect that the deficits are finally beginning to haunt the average American. One reason is that the newspapers, the magazines, and the TV commentators have finally picked up the gauntlet, and the word on the budget disgrace is getting out.

For instance, Ernest Hollings, senior member of the Senate Budget Committee, saw fit to write this letter to *The New York Times* (published on Oct. 25). To put it mildly, the US budget is a lie, a fraud, and a scandal. And finally, finally the nation is being told about it!

I Want A Divorce

By Ernest F. Hollings

WASHINGTON

After four years in a shotgun marriage called Gramm-Rudman-Hollings, I'm filing for divorce on grounds of infidelity and irreconcilable differences.

Back in the autumn of 1985, Republican Senators Phil Gramm, of Texas, and Warren Rudman, of New Hampshire, and I went to the altar with the best of intentions. In the teeth of a $330 billion-plus deficit and a Federal budget process run amok, Gramm-Rudman-Hollings was "a bad idea whose time had come."

The concept was simple and tough-minded: Shackle Congress and the President to a timetable of annual deficit-reduction targets, and back up the law with a doomsday device called "sequestion," the threat of automatic, across-the-board cuts that would kick in if Congress failed to reach the target in a given year.

True, the law enjoyed a blissful two-year honeymoon. Congress and the White House stopped cheating and fibbing, and settled down to cut the budget deficit from $221 billion in 1986 to $150 billion in 1987.

In retrospect, however, this spasm of budget responsibility reminds me of Max Beerbohm's reply when asked if a certain politician ever told the truth. "Occasionally," he quipped, "when his invention flags."

Regrettably, in drafting the budget for fiscal year 1988, our capacity for invention returned in spades. The "budget summit" in the wake of the October 1987 stock market crash was a farrago of budget frauds, and soon deficits were on the way back up: $155 billion in 1988 and $161 billion in 1989.

Today, it is all too clear that "bite the bullet" has lost out to "read my lips." The 1990 budget — a fiscal Rosemary's Baby currently emerging from Congress with Richard Darman, the Budget Director, as midwife — is the deathblow to budget discipline.

The 1990 budget is a spectacular jambalaya of tricks and dodges. For instance, we claim to "save" $2.9 billion by moving a Pentagon payday from Oct. 1, the fiscal new year, to Sept. 29, in fiscal 1989; and to "cut" another $1.8 billion by moving the Postal Service deficit off-budget (along with the $50 billion-plus cost of bailing out the savings and loan industry.)

Of course, this riot of "invention" allows the President and Congress to claim we have done our job by meeting the 1990 deficit limit of $110 billion. But you can see through this Washington con game by following the simple rule of "watch what we do, not what we say."

We say that we are cutting the deficit to $110 billion, but we will soon raise the debt limit — the Treasury's borrowing authority for 1990 — by nearly $300 billion. As it turns out, the true deficit for 1990 will be very close to that $300 billion figure, once you include the huge "off-budget" financing of the savings and loan bailout, promiscuous "borrowing" from the so-called trust funds and so on.

Indeed, the best kept secret in town is that President Bush does have a plan for reducing the deficit (the nominal deficit, not the real deficit), and it involves a whole raft of enormous, hidden taxes. First, there is the Social Security payroll tax (slated to increase again on Jan. 1), which is expected to generate a $65 billion surplus in 1990. All of that will be siphoned off to "reduce" the deficit. Next, there is the "stick it to our children" tax of interest on the national debt, which will total $260 billion in 1990, up $20 billion over 1989. And don't forget the $30 billion in hidden taxes we will pay to rescue the thrifts.

Pundits accuse Mr. Bush of failing to provide leadership on the budget. They're wrong. He is leading, all right, but in the wrong direction. Eight years into Uncle Sam's woozy borrow-and-spend binge, he wants to spike the punch bowl anew with yet another juicy giveaway — a slash in the capital gains levy. The Congressional Budget Office says this will increase the deficit by $67 billion over the next 10 years.

Enough said. This marriage is obviously on the rocks. However, in filing for divorce, let me make an offer of child support: Gramm-Rudman-Hollings remains the last vestige of fiscal constraint. But it's lousy budget poli-

Russell, you may ask, why are you taking up so much space on the budget deficit? The answer is because it's become a critical issue. For decades the US has dealt with its budget deficits via inflation, subterfuge, and lies. The politicians (with the acquiescence of their constituents) just spent their heads off and borrowed the overage. But the US economy now seems to have moved into a deflationary mode. I have always said that debts are inflationary up to a point -- and beyond that point (due to compounding interest costs) they become deflationary. We may have reached the deflationary mode - in fact, I suspect we have.

If so, if deflation or even disinflation has entered the picture, then we're going to have major trouble in the economy. You see, you can't continue to float an ocean of debt in a disinflationary environment. In a disinflationary environment, the burden of carrying debt becomes more and more onerous.

The place where deflation is most obvious (and most ominous) is in the nation's housing market. Across the nation home prices are softening -- in selected areas they are buckling. I've written before that the wealth of the average American lies in the equity in his home. Wipe out the housing profits, cut into home equity values, and this nation will have all the deflationary trouble it can handle.

MOM: A few weeks ago, on September 28, my mother died. She was born on March 11, 1898. About a year ago Mom decided she had lived long enough. She was bedridden, fading, and she told me repeatedly, "I'm too old, I'm just too old." I would answer, "Too old for what, Mom? There are thousands of people who live to be well over 100 today. Who says you're too old?" But my mother was stubborn, and she knew her own mind. "I'm too old," she would repeat. "I'm tired of living."

I knew the end would come soon, because up to that time my mother had always been in love with life. Mom loved traveling and she adored parties. She was a professional writer, having written three novels (one a *New York Times* bestseller) and dozens of short stories and articles. Mom graduated from Hunter College in 1920, at a time when it was not considered "right" for a woman to go to college. Life was tough in those days. Her own mother died when Mom was three, of an infection. Her only sister died at age 27, of a mastoid infection. When mom was eight her father remarried (it was an arranged marriage) a woman who resented my mother and gave her absolutely no affection or love.

My mother met my father during World War I, while my father was on five-day leave from the Naval Air Corp. They were married right after the war, and they had a long, happy life together. My father was absolutely crazy about my mother. My dad died in 1956. The years went by but Mom never remarried. It wasn't for lack of men. After Dad's death many men wanted to marry my mother, and one day I asked her why she never remarried. "Men are more trouble than they're worth," she replied, but I knew the real answer. There was only one man for her, and that man was gone.

My mother always stressed honesty to me. She told me that she didn't care what I did as long as it was honest work. When I was 14 (we were living in Manhattan) I was hit by a taxi. The impact practically hurled me over the top of the cab. Miraculously, I only suffered bad bruises across the front of my legs. Two big New York cops brought me home. My mother opened the door, saw me being held up between the two cops, and gasped, "My God, what has he done?" "He was hit by a car," one of the cops offered. "Whew," sighed my mother, "You scared me. I thought he'd done something bad!" That was my mom. Everything's all right as long as you're honest.

My mother, like almost everyone who had lived through the Great Depression, had been scarred by those dark, difficult days. Mom left careful, typewritten instructions for us regarding what to do when she died. We were to have an informal memorial, and there was to be food and drink for the guests. As to the food, she wrote, "There should be plenty of food, enough for all -- but not too much." That was my mom. She hated waste.

A year or so ago I wrote in one of these Letters that I had made a videotape of my mother, and she had talked for a few hours about her life, her philosophy, her thoughts, and her adventures. That tape is gold now. I'm going to make copies for my kids. In that way they'll know what Grandma (or in some cases what Great-grandma) was really like. Believe me, she was well worth knowing.

NOTES & QUOTES: New York salaries (which often set the tone for the nation) were up an average of 5.7% in 1989. "The increase comes at a time when profits are down and many New York area companies, especially those in financial services, must slash costs to remain competitive," says *Crain's New York.*

* *

In another piece, written before the crash, *Crain's* headline, "Trump Would Rule New York Skies." Not now, he won't, but I'll say one thing for Trump. He knows how to back out of a deal gracefully (I'm talking, of course, about his AMR bid). The truth about the airline bids is that the New York banks were basically the agents. The money for the takeover was coming from Japan. When the UAL deal fell apart, it was the Japanese banks that backed out.

* *

Speaking of the airlines, their earnings have taken a sudden slide over recent weeks. The problems: rising fuel costs, promotional fare cuts, and a slowdown in travel. Last week USAir, recently a stellar performer, posted a $77 million net loss for the third quarter.

* *

Sexually active teenagers who are oblivious of, or don't care about, birth control are costing this nation a fortune. According to the Center for Population Option, a nonprofit educational group, "US taxpayers paid nearly $20 billion in 1988 to support families started by teenage mothers, and each such child born last year will cost $16,500 by 2008."

* *

Vincent van Gogh left 800 paintings and 700 drawings when he died. During van Gogh's tragic lifetime, he sold only a single painting (and that to his brother). But in a trend-setting sale, Australian Alan Bond bought van Gogh's famous *Irises* painting at a Sotheby auction for $57 million. Now it turns out that Bond put down only 50% of the price for the purchase. Sotheby is holding the painting pending receipt of the rest of the money. Dealers and museums are furious. Was the historic sale of *Irises* really a sale? One thing it did was drive up the price of all art, creating an atmosphere of euphoria in the art world. Now dealers are beginning to wonder if all those sky-high art prices were "art in the sky" prices. Meanwhile, on Oct. 22 it was reported that Bond Corp. Holdings Ltd. posted the biggest loss in Australian history -- 980 million in Australian dollars in 1989. Russell comment: I've said this before, and I'll repeat it. The multimillion dollar prices paid for art are tantamount to financial insanity. We'll see art prices (and collectible prices) collapse in the next bear market.

* *

How's this for arrogance or maybe inefficiency? I've been advertising every other week in *Barron's* since 1958. *Barron's* rates kept going up and up, and finally I decided to put my promo money into direct mail rather than *Barron's*. So I dropped my ad after 31 years. That was two months ago. Since then I've heard not a single word from *Barron's*. They never called to ask me why. I guess the advertising department just doesn't need the money.

* *

Bush's choice for head of the new Resolution Trust Corp. Oversight Board (it's charged with setting policy for the $166 billion S&L bailout) is James Simmons, retiring chairman of Valley National Bank, Arizona's largest. Valley has more than $350 million in defaulted real estate loans on its books! By the way, Simmons was Bush's campaign cochairman in Arizona.

* *

Early US presidents had a hard time of it, financially. U.S. Grant left office in debt. Madison left office broke, had to sell his home. Washington's presidency cost him dearly, and a stingy Congress refused repeatedly to pay Washington's troops. But times have changed. The House has voted $1.8 million this year for ex-presidents (office and travel expenses): Reagan gets $559,000, Carter gets $387,000, Ford and Nixon both get $426,000.

* *

What's a good ball club worth today? Ray Kroc bought the Padres in '74 for $12 million. Now, his widow, Joan Kroc (probably the kindest and best-liked owner in baseball), has put the San Diego Padres up for sale. Two years ago she almost sold the Pads to George Agyros for a reported $65 million, but later (for good reasons) she changed her mind. Last month the struggling Seattle Mariners were sold for $80 million. Earlier this year the Baltimore Orioles were sold for $70 million. Probable price for the vastly-improving Padres -- $100 million or more.

* *

Speaking of sports, for the first time in history, blacks have purchased a major league sports franchise. Bertram Lee and Peter Buyoe just bought the Denver Nuggets (basketball) for $65 million.

* *

Finally, in sports, the Oct. 23 *WSJ* tells the NFL story. Players' salaries are eating up the NFL alive, and half of the 28 NFL teams are now losing money. Worse, there is no real source of increased income for the owners. The average salaries plus bonuses of the top players on each team is now $685,000 -- up 44% from last year.

* *

The latest estimate on the cost of the San Francisco earthquake is $5.5 billion. But the S&L bailout costs are estimated at 30 times the cost of the great 1989 earthquake. Furthermore, the S&L situation is worsening, due to mix-ups, inefficiencies, and lack of centralized authority.

* *

Inflation isn't getting better for theater goers in NYC. "Jerome Robbins' Broadway" just boosted prices prices $5 to $55 for its best seats. "Les Miserables," "The Phantom of the Opera" and "Me and My Girl" quietly followed. Most of the new musicals coming in for this season will also have a $55 top tag. By the way, if you live in New York or are visiting New York don't miss "Other People's Money" playing in the Minetta Theatre in the Village. Do Not Miss It!

* *

For Arizona real estate, it's deflation, not inflation. This quote from C.W. Jackson, a prominent Arizona builder tells the story: "It's horrible, but it's unfortunate that earthquake wasn't in Phoenix -- it might have knocked out some of our empty buildings. . . . It's reasonable to say there's not a solvent S&L in the state and the amount of viable bank capital is very low. We're going to see another big wave of failures and defaults between now and yearend."

* *

Inflation -- a Coin Record: Last week an 1852 $20 US gold coin sold for $1.35 million, the highest verified price ever paid for a US coin.

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Time magazine's cover story ("The Death of Government") last week asked the question whether government still works at all. The *Washington Post Weekly* last week carried a Kevin Phillips piece entitled: "The Democrats and Republicans: Dead From the Neck Up? They're Out of Sync, Out of Ideas and Out to Lunch." Phillips starts: "From the White House to Capitol Hill, the critical weakness of American politics and governance is becoming woefully apparent -- a frightening inability to define and debate America's emerging problems. For the moment, our political culture appears to be brain dead. Politicians from both parties seem unsure whether the economy is weak or strong, whether the US is globally winning (over Russia) or losing (to Japan). The parties seem like rudderless vessels, afloat on a sea of compromise, caution and confusion." Russell comment: Yeah, I've been saying the same thing for quite a while. I'm glad somebody else noticed.

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Michael Eisner isn't the only Disney exec making megabucks. Last year Frank Wells, president of Disney, earned $32 million (Eisner

earned $40 million). On top of that, Wells exercised Disney stock options for a profit of $74.2 million. So it pays to be right (and Wells and Eisner have been the two rightest people in entertainment).

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One of the really big retail struggles is happening in Britain where Britain's eccentric Tiny Rowland is trying to wrest control of Harrod's department store from Egyptian Mohamed al-Fayed. Harrod's is a fantastic store, occupying a huge square block of London (five stores, 20 acres of selling space and 300 departments). Its sales are $1 billion a year. Faye and I spent a whole day in Harrod's last May, and we were amazed (particularly at the spectacular food sections).

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In January 1990 Social Security will boost payments 4.7%. The latest boost follows a long string of payment raises. A glance at this chart gives you some idea of the cost of inflation in America. No wonder Alan Greenspan dreams of an America with "zero inflation." So far, of course, it's only a dream. As I've said before, with the estimated over $10-12 trillion in debt the US is carrying, it is doubtful whether the nation could survive in a noninflationary environment.

Social Security

The annual cost-of-living increases that Social Security beneficiaries have received since 1975

July 1975:	8.0%
July 1976	6.4%
July 1977	5.9%
July 1978	6.5%
July 1979	9.9%
July 1980	14.3%
July 1981	11.2%
July 1982	7.4%
Jan. 1984	3.5%
Jan. 1985	3.5%
Jan. 1986	3.1%
Jan. 1987	1.3%
Jan. 1988	4.2%
Jan. 1989	4.0%
Jan. 1990	4.7%

Six months were skipped in 1983 to help bail Social Security out of a crisis.

* *

Lowell Cohen of the *San Francisco Chronicle* said some bad things about Chicago and the Cubs, and that made Mike Royko of the *Chicago Tribune* angry. "As long as you mentioned brains," writes Royko, "Here's some trivia. Stanford has had 13 Nobel Prize winners. The University of California at Berkeley has had 15. Very nice. But the University of Chicago has had 57 Nobels. Put that in your skull and rattle it. . . . Chicago, as any national restaurant critic will tell you, has greater variety and more world-class restaurants than San Francisco can ever dream of. Yet, who am I to differ with San Francisco newsmen? After all, in the past 30 years San Francisco papers have won a stunning total of one Pulitzer Prize, while Chicago papers picked up a mere 25. San Francisco has nothing to compare with our Chicago Symphony. We are a close second only to New York in exciting, original theater. Our architecture, old and new, makes San Francisco look like a whistle-stop. Our literary tradition (Hemingway, Sandburg, Bellow, Algren, Terkel, and on and on) makes the queen city look like a remedial English class." Boy, I mean Royko is mad. Russell comment: I agree with Royko on almost all counts, but gad, who can stand those Chicago winters? (All of this, of course, was written before the tragic San Francisco earthquake).

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GOLD: There are two forces that will drive gold higher: (1) the rise of inflationary expectations; and (2) if the financial system appears to be in danger.

As outlined in these Letter over many months, gold appears to have built a base with the extreme low for the metal at 359. In recent reports I stated that gold was being accumulated, and I pointed to the "rounding bottom" in the metal. Last Friday (Oct. 27) was the day when gold seemed to come to life. On that day the nearby October gold contract rose $5.80 to close at $378.30 -- up $5.80 for the day. I received calls from all over and the talk was, "Russell, have you seen the gold shares? North American, South African, all the gold shares are breaking out to new highs." Yes, I was watching the shares, and the rise was impressive. On Friday, XAU, the Philadelphia Gold/Silver Average, closed at 107.64, its highest level since July 1988. At the same time, ASA closed at 49 5/8, a new high for the year.

Few people realize it, but since September 1 gold has actually been outperforming common stocks. On September 1 my gold/stock ratio (i.e., London gold afternoon fix divided by the NYSE Composite) was at 183. On Friday the ratio was at 202. One of the prerequisites of a gold bull market is a rising gold/stock ratio. A rising gold/stock ratio does not guarantee a gold bull market, but as I said, a rising gold/stock ratio is a prerequisite of a gold bull market. The gold/stock ratio has been rising for the past two months. Gold opened (spot) at 378.50 on October 30, above the 144-day moving average for gold, which is currently 372. Nothing's proved yet, but all the above are certainly positive for gold.

In the last Letter I included a chart of the Lexington Gold Fund. I stated that "a strong base has formed," and that the fund had moved up for four successive months -- and was now above its long-term moving average. Lexington continues to act well.

So what's happening? (1) Gold could simply be reacting to an big declining market in stocks. (2) Gold could be hinting at a potential run on the dollar -- to occur somewhere in the future. In my opinion, the US government cannot continue to run deficits of $600 million per day and hope to see the dollar hold together. (3) Or seeing common shares cave in day after day (IBM closed under 100 on Oct. 27!), investors and traders may simply be getting nervous. When investors' stomachs start churning, they have a habit of reaching for gold and gold shares.

If you are a patriotic American (and you believe in the dollar), it is never a pleasure to see anything resembling a bull market in gold. It is too early to state that a gold bull market has started. However, if gold moves above 400 it could be the start of something big. I continue to buy a monthly fixed-dollar amount of gold coins. The more speculative minded might take a position in a few of the gold shares. American Barrick and Placer Dome (both NYSE and both recommended in Letter 1026) are two of the best.

LATE NOTES: The October 13 crash low for the Dow was **2569.25.** This is now a key level. If the Dow breaks below this level on increasing volume it would dramatically increase the odds that a primary bear market is under way.

The advance-decline ratio has been plunging and as of Friday (Oct. 27) it was down almost three full points from its August 8 high. Just as significant, the NYSE Financial Index (containing ALL financial-related stocks from S&Ls to banks to brokers to small loan companies) has sunk to its lowest level since last July.

My PTI remains a major point of interest as far as my own thinking is concerned. The PTI measures eight market forces, and it does not reverse trends quickly or easily. The PTI, as this is written, is at 3257. This is down 32 points from its early October high. The 89-day moving average of the PTI is now 3196, which means that the PTI is still 61 points above that very important moving average. The PTI moving average, for the first time in many months, is beginning to flatten out.

Bear market rallies tend to move the PTI grudgingly, so I am particularly interested to see how the PTI does in the next sustained rally.

DowPow (my own index of the Dow adjusted for the action of the advance-decline ratio) has dropped to 560, thereby wiping out literally all of the gains of 1989. I tend to view DowPow as a proxy for how the public or the typical stock portfolio is doing. DowPow is saying that 1989 started out fine, but is ending less than rosy. Between DowPow's action and program trading, the public must now be rather groggy. (On Oct. 30, Neuberger & Berman, which handles $17 million in funds, published full-page ads in the *WSJ* and *The NY Times* denouncing program trading. When the funds start complaining in public, you can bet program trading is hurting business.)

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